

#2593

signed 1-16-03

**IN THE UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF KANSAS**

In re:

PEGGY JOAN WEIXELMAN,

DEBTOR.

**CASE NO. 00-40743-13
CHAPTER 13**

**ORDER DETERMINING THAT THE BANKRUPTCY COURT CAN IMPOSE AN
EQUITABLE LIEN OR CONSTRUCTIVE TRUST ON EXEMPT PROPERTY,
AND SCHEDULING STATUS CONFERENCE**

This matter is before the Court for resolution of two legal questions raised by objections to confirmation of the debtor's chapter 13 plan. Debtor Peggy Joan Weixelman ("Debtor") appears by counsel Frank D. Taff. Objecting creditor Rubber Worker's Credit Union ("RWCU") appears by creditor Justice B. King. Objecting creditor Glen I. Atwood, executor of the estate of Dorothy A. Fry, deceased ("Executor"), appears by counsel Michael F. Brunton. Chapter 13 Trustee Jan M. Hamilton appears personally. The Court has reviewed the relevant materials and is now ready to rule.

FACTS

In February 2000, the Executor sued the Debtor and RWCU in a Kansas state court. The Executor asserted two causes of action against the Debtor, alleging that she had exercised undue influence to induce Dorothy A. Fry ("Fry") to transfer money to her, and had also forged Fry's indorsement on checks that she then deposited into her own RWCU account. The Executor asserted a cause of action against RWCU under K.S.A. 84-3-420, alleging that RWCU converted Fry's checks by depositing them with the forged endorsements.

The Debtor filed for bankruptcy in April 2000. Among other things, she has claimed her home and truck as exempt. Before this Court, RWCU asks to have an equitable lien or constructive trust imposed on the Debtor's home and truck, alleging that she repaid loans to RWCU that had been secured by that property using some of the money that the Executor claimed she had improperly obtained from Fry. The Executor joins RWCU in seeking imposition of an equitable lien or constructive trust.

DISCUSSION

The parties presently ask the Court to resolve two legal questions: (1) whether a bankruptcy court can impose an equitable lien or constructive trust if it finds that allegations like those the Executor and RWCU have made against the Debtor here are true; and (2) whether such a lien or trust can be imposed against exempt property. If the Court concludes that the answer to each question is yes, then a trial will be necessary to determine whether the allegations of wrongdoing are true.

Many courts, including federal courts in the District of Kansas in *In re Petroleum Products, Inc.*, and *In re Leitner*, and a Missouri bankruptcy court in *In re Lett* have concluded that a bankruptcy court can properly impose an equitable lien or constructive trust against property in Kansas (or at least against otherwise exempt property) that a debtor obtained through fraud or other improper actions.¹ It is true that the Sixth Circuit in *In re Omegas* declared that a bankruptcy court cannot

¹See *In re Petroleum Prods., Inc.*, 150 B.R. 270, 272-74 (D.Kan. 1993) (bankruptcy court properly recognized equitable lien, analogous to constructive trust, against property to prevent unjust enrichment); *Clark v. Wetherill (In re Leitner)*, 236 B.R. 420, 423-25 (Bankr.D.Kan. 1999) (bankruptcy court imposed constructive trust against homestead purchased with money embezzled from corporation); *First American Title Ins. Co. v. Lett (In re Lett)*, 238 B.R. 167, 197-99 (Bankr. W.D. Mo. 1999) (at least to the extent of exempt property obtained with proceeds of fraud, bankruptcy

impose a constructive trust, or even enforce one imposed postpetition by a state court, because to do so would be contrary to the distribution scheme established by the Bankruptcy Code.² As the court noted in *Lett*, though, a constructive trust imposed against a debtor's exempt property would not interfere with the Bankruptcy Code's distribution scheme—and so would not offend the *Omegas* rationale—because that property would not be available to pay other creditors even if no constructive trust were imposed.³ Furthermore, despite the broad pronouncements in *Omegas*, the Sixth Circuit recently ruled in *In re Newpower* that a bankruptcy court should lift the automatic stay to permit a state court to proceed to determine in a suit commenced prepetition whether it should impose a constructive trust against property of the debtor, and that the *Omegas* decision would not preclude the bankruptcy court from enforcing a judgment entered by the state court.⁴ The opinion distinguished *Omegas* on the grounds that it had not involved a debtor who was a thief, or the question of enforcing a state court judgment that imposed a constructive trust against property that otherwise belonged to the debtor.⁵ The Court is satisfied that, even if *Omegas* correctly concluded that a bankruptcy court cannot impose a constructive trust when doing so would interfere with the Bankruptcy Code's distribution scheme, the *Omegas* reasoning does not preclude a bankruptcy court from imposing an equitable lien or

court could impose constructive trust to return property to its proper owner).

²*XL/Datacomp, Inc., v. Wilson (In re Omegas Group, Inc.)*, 16 F.3d 1443 (6th Cir. 1994).

³*Lett*, 238 B.R. at 198-99.

⁴*Kitchen v. Boyd (In re Newpower)*, 233 F.3d 922, 934-37 (6th Cir. 2000) (note that the opinion of the court on this point appears after the main opinion, the author of which dissented from this holding, *see pp.* 931-33).

⁵*Newpower*, 233 F.3d at 936-37.

constructive trust against property that is exempt from the claims of the debtor's other creditors.

The Court sees no reason not to follow the *Petroleum Products*, *Leitner*, and *Lett* decisions in this case. If the Executor and RWCU can establish that the Debtor improperly obtained property from Fry by exercising undue influence over her and forging her endorsement on checks, and can trace her ill-gotten proceeds to her exempt property, the Court is convinced that it would be appropriate to impose a constructive trust against that property to remedy the Debtor's wrongdoing. Under appropriate circumstances, Kansas law allows such a trust to be imposed against exempt property, even a homestead.⁶

Consequently, it appears that an evidentiary hearing will be necessary in order to determine whether the allegations of the Debtor's wrongdoing are true, and whether the proceeds of any such wrongdoing can be traced to her exempt property. A status conference is hereby scheduled for Monday, February 24, 2003, at 4:00 p.m. in the Court's conference room to address procedures for getting this matter resolved.

IT IS SO ORDERED.

Dated at Topeka, Kansas, this ____ day of January, 2003.

⁶See *Lett*, 238 B.R. at 199-200 (citing *Metz v. Williams*, 149 Kan. 647 (1939); *Long v. Murphy*, 27 Kan. 375 (1882); and *McConnell v. Wolcott*, 70 Kan. 375 (1904)); see also *leitner*, 236 B.R. at 423-26 (imposing constructive trust against debtor's homestead).

JAMES A. PUSATERI
BANKRUPTCY JUDGE